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CONSUMER INJURY IN ANTITRUST LITIGATION: NECESSARY, BUT BY WHAT STANDARD?

WILLIAM H. ROONEY†

INTRODUCTION

Since the early days of the rule of reason under section 1 of the Sherman Act, the effect of the challenged conduct on competition has been central to whether the conduct is lawful.¹ The Clayton Act also makes the actual or likely competitive effect of the arrangement in question directly relevant to the lawfulness of that arrangement under that statute.² In addition, the Supreme Court—under section 2 of the Sherman Act—has clarified that competitive effect is relevant to the lawfulness of conduct challenged as either attempted or actual monopolization.³

Aside from cases governed by the per se rule of illegality or the quick-look doctrine, proving that the conduct in question has or would cause an “anticompetitive” effect has thus been an

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¹ See *State Oil v. Khan*, 522 U.S. 3, 10 (1997).

² See e.g., *United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1281 (7th Cir. 1990) (acknowledging the similarity in judging the lawfulness of conduct under the Sherman and Clayton Acts).

³ See *United States v. Du Pont & Co.*, 351 U.S. 377, 389 (1956) (“Our cases determine that a party has monopoly power if it has . . . a power of controlling prices or unreasonably restricting competition.”) (internal quotation and citation omitted); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 457 (1993) (“In order to determine whether there is a dangerous probability of monopolization, courts have found it necessary to consider the relevant market and the defendant’s ability to lessen or destroy competition in that market.”).

element of most substantive antitrust claims separate and apart from the "antitrust injury" standing requirements that have been developed since *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*⁴ As courts have increasingly looked to economics to "inform the antitrust laws," the metes and bounds of a legally cognizable "anticompetitive" effect have been more clearly defined. The driving concept, though not always stated, seems to have been allocative efficiency: whether the challenged conduct distorts the allocation of economic resources in the production of goods and services that consumers value most.⁵

Preserving allocative efficiency fits easily within the traditional antitrust framework. Relevant consumer preferences are reflected in market definition,⁶ allocation is reflected in the current and potential supply of the relevant product or service, and distorted allocation is reflected in a reduction in the output—and a corresponding increase in the price—of the products or services comprising the relevant market.⁷ Output, of course, is multi-dimensional and is understood broadly. It includes the quantity of the product or service as well as its quality, which in turn includes functionality, branding, features, and innovation.

Competitive effect is assessed in light of the impact of the practice on the allocation of resources. From the perspective of allocative efficiency, an anticompetitive effect occurs when the challenged conduct restricts output in a properly defined relevant market, in a material amount, for a material duration. A procompetitive effect occurs when the practice in question expands output in the relevant market in a material amount for a material duration. A competitively neutral act has no material effect on the relevant output.

Reducing output typically causes, and is most obviously

⁴ 429 U.S. 477 (1977).

⁵ See *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1433 (9th Cir. 1995).

⁶ See *L.A. Draper & Son v. Wheelabrator-Frye, Inc.*, 735 F.2d 414, 425 (11th Cir. 1984); *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

⁷ See, e.g., Stephen Ross, *Did the Canadian Parliament Really Permit Mergers That Exploit Canadian Consumers So The World Can be More Efficient?*, 65 ANTITRUST L.J. 641, 644 n.14 (1997) (explaining "deadweight loss" as the harm caused to the economy "when consumers because of higher prices choose an alternate and less appropriate substitute product for the use they have in mind"). "This inefficient substitution is seen as a misallocation of resources; it is seen as a loss to society as a whole." *Id.*

reflected in, an increase in price—a harm that is acutely felt by consumers.⁸ Some courts have accordingly identified the objective of the antitrust laws as protecting consumers (“consumer welfare”), not competitors. Indeed, the Supreme Court in *Reiter v. Sonotone Corp.* described the Sherman Act as a “consumer welfare prescription.”⁹ Hence, the moniker “consumer injury” has developed as a shorthand means of describing the anticompetitive effect required for a successful antitrust claim.

Although the debate over consumer injury in antitrust litigation is intense, much of the above is not widely disputed. As discussed in Part I below, courts and the enforcement agencies generally agree that antitrust analysis (other than that governed by the per se rule and the quick-look doctrine) turns on the competitive effect of the practice in question and that such an effect involves more than harm to a single rival.¹⁰ They also agree that an anticompetitive effect relates to the actual or anticipated impact of the challenged conduct on output and price in a relevant market—or in shorthand, on consumers.¹¹ Can we imagine a press release by an enforcement agency that claims its enforcement of the antitrust laws, instead of vindicating consumer interests, has protected competitors, dispersed political or economic power, advanced populism, or eliminated corporate corruption?

The consensus ends there, however, as courts assess competitive effects very differently. Although most seem to agree that proof of consumer injury is necessary in antitrust litigation, many disagree over the standard for proving that injury. The crucial debate is what evidence is sufficient to support a finding that, more likely than not, the challenged conduct was (under section 4 of the Clayton Act) or would likely be (under section 16 of the Clayton Act) the proximate cause of a material reduction in output and increase in price in a properly defined relevant market for a material period of time. A resolution of that debate has not yet emerged. The differences are reflected both in the evidence from which courts are willing

⁸ See *Rebel Oil*, 51 F.3d at 1434 n.4.

⁹ 442 U.S. 330, 343 (1979) (citation and internal quotations omitted).

¹⁰ See, e.g., *Rebel Oil*, 51 F.3d at 1433.

¹¹ See *Pool Water Prods. v. Olin Corp.*, 258 F.3d 1024, 1034 (9th Cir. 2001); *Anago, Inc. v. Tecno Med. Prods. Inc.*, 976 F.2d 248, 249 (5th Cir. 1992).

to infer consumer injury and in the scope of the relevant output as to which competitive effects are measured. Part II addresses two of the issues on which courts vary in assessing competitive effect, and discusses cases illustrating those differences.

The first issue poses the question of what inferences can be drawn from an injury to rivals that results either from output-expanding conduct or output-restricting conduct on the part of the defendant(s). Some courts find injury to rivals to be probative of consumer injury on the ground that numerous competitors generate the very rivalry that ultimately benefits consumers.¹² Other courts find injury to rivals to be probative of consumer benefit as that injury typically results from intense competition, which in turn usually expands output and lowers prices. Courts also differ in the inferences they draw from harm to rivals regarding claimed limitations on consumer choice and the relevance of those claims to aggregate consumer welfare.

The second issue addresses the scope of the "marketwide" impact that must be shown for a finding of consumer injury. On one hand, marketwide impact could be assessed in terms of the output only of the relevant product and its next-best substitutes, as is sometimes suggested by both enforcement agencies and courts in cases where products are differentiated by branding, price, or features but similar in functionality.¹³ On the other hand, marketwide impact, even where the products are reasonably differentiated, could include the output of the relevant product and other products which, based on their objective characteristics and physical availability, would be functionally interchangeable with the relevant product in the event its output was restricted or its price increased. We discuss the issue in connection with retail format (superstores compared to mass merchandisers and "anchor" hospitals versus "community" hospitals), a broad price/quality continuum (price and functionality of various writing instruments), and geographic consumption patterns (patient and managed care consumption alternatives).

¹² See *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 44 (D.D.C. 2000) (explaining that Microsoft's actions injured rivals that form a part of the computer industry's competitive process, which the court apparently presumed, generally stimulated innovation and benefited consumers), *aff'd in part, rev'd in part*, 253 F.3d 34 (D.C. Cir. 2001).

¹³ See *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1074 (D.D.C. 1997).

I. THE ANTITRUST OBJECTIVE

Courts and enforcement agencies agree that the Sherman Act addresses only competitive injuries that have a market dimension beyond harm to a single competitor.

The Supreme Court has, on a number of occasions over the last few decades, confirmed that the remedial scope of the antitrust laws is limited to competitive injuries. In *Gordon v. New York Stock Exchange*¹⁴ for example, the Supreme Court found the respective scope of the antitrust laws and the securities laws to differ significantly and potentially to conflict: “[The] sole aim of antitrust legislation is to protect competition, whereas the SEC must consider, in addition, the economic health of the investors, the exchanges, and the securities industry.”¹⁵ In *City of Columbia v. Omni Outdoor Advertising, Inc.*,¹⁶ the Court clarified that political corruption, though otherwise unlawful, lies outside the scope of the Sherman Act: “Congress has passed other laws aimed at combating corruption in state and local governments. ‘Insofar as [the Sherman Act] sets up a code of ethics at all, it is a code that condemns trade restraints, not political activity.’”¹⁷

In *NYNEX Corp. v. Discon, Inc.*,¹⁸ the Court rejected as cognizable under the Sherman Act, claims that the defendant attempted to defraud customers by “hoodwinking regulators”: “[O]ther laws, for example, ‘unfair competition’ laws, business tort laws, or regulatory laws, provide remedies for various ‘competitive practices thought to be offensive to proper standards of business morality.’”¹⁹ The Court has consistently defined the objective of antitrust analysis as limited solely to the competitive impact of the conduct in question: “[T]he purpose of [antitrust] analysis is to form a judgment about the competitive significance of the restraint; it is not to decide whether a policy favoring competition is in the public interest, or in the interest of the members of an industry.”²⁰

¹⁴ 422 U.S. 659 (1975).

¹⁵ *Id.* at 689.

¹⁶ 499 U.S. 365 (1991).

¹⁷ *Id.* at 378–79 (quoting *E. R. Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 140 (1961)).

¹⁸ 525 U.S. 128 (1998).

¹⁹ *Id.* at 137 (citation omitted).

²⁰ *National Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 692 (1978).

The Court has been equally clear that competitive significance is not to be judged solely with reference to the impact of the challenged conduct on a single competitor. Even in *Brown Shoe Co. v. United States*,²¹ viewed by some as initiating restrictive antitrust jurisprudence, the Court emphasized that the antitrust laws protect "*competition, not competitors*."²² That the Court was charting the standard for applying the incipency provision of section 7 of the Clayton Act makes the statement all the more noteworthy. The Court has had many occasions since *Brown Shoe*. to transform that proposition into an antitrust mantra, emphasizing the public or market-related dimension of the competitive injury requirement on many occasions.

In the section 1 context, the Court in *California Dental Ass'n v. FTC*,²³ recently identified the ultimate issue under the competitive effect element of a rule of reason case as the impact of the challenged conduct on the "total delivery" of the relevant product or service in the relevant market:

[T]he relevant output for antitrust purposes here is presumably not information or advertising, but dental services themselves. The question is not whether the universe of possible advertisements has been limited (as assuredly it has), but whether the limitation on advertisements obviously tends to limit the *total delivery of dental services*.

The Court has made the same point in the context of section 2 of the Sherman Act, where the rule of reason is replaced with a framework that focuses on the acquisition or maintenance of monopoly power through exclusionary conduct. In *Spectrum Sports, Inc. v. McQuillan*,²⁴ the Court confirmed that, in a claim of attempted monopolization, the plaintiff must demonstrate not only that the defendant had engaged in exclusionary, unfair, or predatory conduct, but also that the defendant had a dangerous probability of monopolizing the relevant market:

The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself. It

²¹ 370 U.S. 294 (1962).

²² *Id.* at 320.

²³ 526 U.S. 756 (1999).

²⁴ 506 U.S. 447, 458-59 (9th Cir. 1993).

does so not out of solicitude for private concerns but out of concern for the public interest.²⁵

In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,²⁶ the Court addressed primary-line price discrimination under the Robinson-Patman Act and discussed, by direct analogy, predatory conduct under section 2 of the Sherman Act.²⁷ The Court required that a plaintiff demonstrate a likelihood that the defendant would recoup through supracompetitive prices its investment in the predatory scheme.²⁸ Without recoupment, the Court noted, "predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced.... [U]nsuccessful predation is in general a boon to consumers."²⁹ Emphatically affirming the *Brown Shoe* statement that the antitrust laws protect competition not competitors, the *Brooke Group* Court stated that "[e]ven an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws; those laws do not create a federal law of unfair competition or 'purport to afford remedies for all torts committed by or against persons engaged in interstate commerce.'"³⁰

The circuits have followed the Supreme Court's lead with considerable clarity. The Second Circuit, for example, requires that a plaintiff prove that the challenged conduct had (or threatens) an actual adverse effect on competition as a whole in the relevant market.³¹ The Seventh Circuit has held that a plaintiff, to establish competitive injury, must prove not an injury to a rival, but rather the "ability [of the defendant] to control output and prices, an ability that depends largely on the

²⁵ *Id.* at 458; see also *Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346, 1356 (Fed. Cir. 1999) ("The Sherman Act is a law in the public, not private, interest. And even if the district court's view of Intel as a monopolist were accepted, . . . to constitute a violation [of Section 2 of the Sherman Act,] the monopolist's activities must tend to cause harm to competition; unrelated harm to an individual competitor or consumer is not sufficient.") (citation and internal quotations omitted).

²⁶ 509 U.S. 209 (1993).

²⁷ See *id.* at 221.

²⁸ See *id.* at 224.

²⁹ *Id.*

³⁰ *Id.* at 225 (quoting *Hunt v. Crumboch*, 325 U.S. 821, 826 (1945)).

³¹ See, e.g., *Capital Imaging Assocs., v. Mohawk Valley Med. Assocs.*, 996 F.2d 537, 547 (2d Cir. 1993) (denying plaintiff's antitrust claim because it failed to show that "defendants' activities have had any adverse impact on price, quality, or output of medical services offered to consumers in the relevant market").

ability of other firms to increase their own output in response to a contraction by the defendants.”³² The Ninth Circuit requires that the challenged conduct “harm[] both allocative efficiency and raise[] the prices of goods above competitive levels or diminish[] their quality.”³³ The District of Columbia Circuit evaluates a “firm’s ability to restrict output and hence to harm consumers” when deciding whether an act violates the antitrust laws.³⁴

The enforcement agencies also seem to acknowledge that an anticompetitive effect consists of a marketwide decrease in output and increase in price. The Horizontal Merger Guidelines,³⁵ for example, contemplate the initial definition of a relevant market, consider a variety of supply responses, and ultimately assess the impact of the proposed transaction on prices and output in the relevant market.³⁶ The Antitrust Guidelines for Collaborations Among Competitors³⁷ describe the rule of reason as focusing on the state of competition (presumably within a properly defined relevant market) with, as compared to without, the relevant agreement among competitors.³⁸ The guidelines identify the “central question” as “whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what

³² *Ball Mem'l Hosp., Inc. v. Mutual Hosp. Ins., Inc.*, 784 F.2d 1325, 1336 (7th Cir. 1986). “[I]njuries to rivals are byproducts of vigorous competition, and the antitrust laws are not balm for rivals’ wounds. The antitrust laws are for the benefit of competition, not competitors.” *Id.* at 1338.

³³ *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1433 (9th Cir. 1995); *see also* *W. Wholesale Supply, Inc. v. Holladay*, [2002-1 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 73,578 (9th Cir. 2001).

³⁴ *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 219 (D.C. Cir. 1986); *see also* *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1053–55 (8th Cir. 1999) (deciding whether conduct is anticompetitive by evaluating the consumers’ alternatives on a marketwide basis); *SCFC LLC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 965 (10th Cir. 1994) (“To be judged anticompetitive, the [conduct] must actually or potentially harm consumers. That concept cannot be overemphasized and is especially essential when a successful competitor alleges antitrust injury at the hands of a rival.”) (citation omitted).

³⁵ U.S. DEPT OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES (1997).

³⁶ *See id.*

³⁷ U.S. DEPT OF JUSTICE & FTC, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

³⁸ *Id.* § 1.2.

likely would prevail in the absence of the relevant agreement.”³⁹

Courts and the enforcement agencies thus appear to agree that consumer injury—an actual or threatened marketwide, material, and sustained reduction in output (quantity or quality) and corresponding increase in price—is a necessary element in antitrust litigation not involving the per se rule of illegality or the quick-look doctrine. As we shall see below, however, courts differ significantly on the standard by which they assess whether a consumer injury has or will occur.

II. CONSUMER INJURY: BY WHAT STANDARD?

Courts use different standards to determine whether the requisite consumer injury has been proven.

In *California Dental*, the Court stated that except where “an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets,”⁴⁰ the competitive effects issue poses a factual and perhaps largely empirical question the answer to which cannot be based on either theory or presumption alone:

[T]he absence of any empirical evidence on [competitive effects] indicates that the question was not answered, merely avoided by implicit burden shifting The point is that before a theoretical claim of anticompetitive effects can justify shifting to a defendant the burden to show empirical evidence of procompetitive effects, as quick-look analysis in effect requires, there must be some indication that the court making the decision has properly identified the theoretical basis for the anticompetitive effects and considered whether the effects *actually* are anticompetitive. Where, as here, the circumstances of the restriction are somewhat complex, assumption alone will not do.⁴¹

The Court, however, offered no prescription for assessing competitive effect and indeed noted the flexibility of the inquiry, suggesting that it be “meet for the case, looking to the circumstances, details, and logic of a restraint.”⁴² Lower courts are thus left to develop a consistent framework for evaluating

³⁹ *Id.*

⁴⁰ 526 U.S. 756, 770 (1999).

⁴¹ *Id.* at 775 n.12 (emphasis added).

⁴² *Id.* at 781.

the competitive effect, and hence the lawfulness, of conduct challenged under the antitrust laws.

That framework has not yet emerged. Courts accord different significance to similar categories of evidence and seemingly use different standards to assess marketwide impact.⁴³ Determining the significance of harm to rivals and the scope of relevant output provides two examples of issues on which courts have reached inconsistent conclusions on consumer injury.

A. *Harm to Rivals: Indicative of Consumer Injury or Benefit?*

One of the great debates of current antitrust jurisprudence addresses what inferences, if any, can be drawn from harm to competitors. As discussed below, some argue that harm to rivals—at least without a “legitimate” business reason—implies that the defendant engaged in “exclusionary” conduct, injures the “competitive process,” impairs consumer choice, and provides an adequate basis for inferring consumer injury. After all, competitors are the prime ingredient of competition, and harming competitors necessarily, at least to a certain extent, harms competition.

Others argue that conduct can be characterized as “exclusionary” only if it restricts, and not expands, total output; that bankruptcies are common in highly competitive markets; that the blood of a competitor generally implies a benefit for consumers; and that courts should be particularly skeptical of any antitrust claim predicated upon a rival’s wounds. Needless to say, the courts have reached no consensus on those issues.

We discuss below differences among courts in their willingness to find an antitrust violation based upon harm to rivals that (1) resulted from *output-expanding* conduct; (2) resulted from *output-restricting* conduct; and (3) limited “consumer choice.”

B. *Output-Expanding Conduct*

Harm to rivals through output-expanding conduct usually arises in cases of alleged predation. The expansion of output is

⁴³ Compare *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224–25 (1993) (requiring recoupment evidence in order to find a violation), with *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9 (D.D.C. 1999) (finding a violation in the absence of recoupment evidence).

generally implemented through lower prices, greater advertising, improved quality, or broader distribution. The conduct is often challenged under section 2 of the Sherman Act, as the alleged predator increases its share of the averred market—or maintains its monopoly position—at the expense of the harmed rival.

In *United States v. Aluminum Co. of America*,⁴⁴ the Second Circuit identified Aluminum Company of America's (ALCOA) aggressive expansion of output as a willful scheme to exclude rivals and an unlawful means of maintaining its monopoly position:

The only question is whether it falls within the exception established in favor of those who do not seek, but cannot avoid, the control of a market. It seems to us that that question scarcely survives its statement. It was not inevitable that [ALCOA] should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled [ALCOA] to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel.⁴⁵

The court made no finding that ALCOA's "doubling and redoubling capacity" had, or would, raise the price of ingot to consumers. The focus was on ALCOA's maintaining its large share and the harmful effect on rivals. Given ALCOA's success and its rivals' failure, liability followed.

Judge Jackson in *United States v. Microsoft Corp.*,⁴⁶ like Judge Hand in *Aluminum Co. of America*, focused on the exclusionary effect of the defendant's aggressive—though seemingly output-expanding—conduct. Indeed, portions of the district court's opinion were predicated on the output-expanding characteristic of Microsoft Corporation's ("Microsoft") conduct and the injurious impact it had on middleware threats to Microsoft's operating system:

⁴⁴ 148 F.2d 416 (2d Cir. 1945).

⁴⁵ *Id.* at 431.

⁴⁶ 87 F. Supp. 2d 30 (D.D.C. 2000), *aff'd in part, rev'd in part, remanded*, 253 F.3d 34 (D.C. Cir. 2001).

Microsoft paid vast sums of money, and renounced many millions more in lost revenue every year, in order to induce firms to take actions that would help enhance Internet Explorer's share of browser usage at Navigator's expense Microsoft has no intention of ever charging for licenses to use or distribute its browser. Moreover, neither the desire to bolster demand for Windows nor the prospect of ancillary revenues from Internet Explorer can explain the lengths to which Microsoft has gone. *In fact, Microsoft has expended wealth and foresworn opportunities to realize more in a manner and to an extent that can only represent a rational investment if its purpose was to perpetuate the applications barrier to entry.* Because Microsoft's business practices "would not be considered profit maximizing except for the expectation that . . . the entry of potential rivals" into the market for Intel-compatible PC operating systems will be "blocked or delayed," Microsoft's campaign must be termed predatory. Since the Court has already found that Microsoft possesses monopoly power, the predatory nature of the firm's conduct compels the Court to hold Microsoft liable under § 2 of the Sherman Act.⁴⁷

The district court acknowledged that, at least in some respects, Microsoft's payment of vast sums of money and its renouncement of many millions more to expand the output of Internet Explorer redounded to the benefit of consumers.⁴⁸ The district court made findings that indicated that browser output during the period of alleged predation increased fourfold from around fifteen million browsers to over sixty million browsers. Microsoft's output increased by a factor of about ten and Netscape's output more than doubled.⁴⁹ The price of browsers dropped during the same period to effectively zero.

Microsoft also appears to have expanded output in terms of the quality of the package of the operating system and browser software that it offered (putting aside the question of whether that package constituted one product or two). For most computer users, receiving Windows with Internet Explorer presumably was preferable to Windows without Internet Explorer at the same price. Indeed, to perpetuate the "applications barrier to entry," Microsoft necessarily had to increase during the period in question both the quantity and

⁴⁷ *Id.* at 44 (emphasis added) (citations omitted).

⁴⁸ *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 110-11 (D.D.C. 1999).

⁴⁹ *See id.* at 297, 302, 326.

quality of its browser output as well as that of its operating system/browser package. Given that Windows was compatible with Netscape's Navigator, Microsoft would not likely have taken substantial browser usage share from Netscape if Microsoft had distributed a materially inferior Internet Explorer.

Although the court found that consumers would be harmed through diminished innovation, Microsoft's threatening and harming rivals, and the inconvenience and burden to some of receiving an unwanted browser,⁵⁰ the court made no explicit finding of "recoupment" by Microsoft. That is, the court did not find that Microsoft would raise the price of either browsers or operating systems or even that the then-current price of the Windows operating system was at the monopoly level.⁵¹ Nor did the court find that Microsoft had sold the operating system/browser package at a level below cost or that, as a result of Microsoft's actual pricing or other competitive strategies, Microsoft would raise or return the price of its operating systems or browser to the monopoly levels.

The court found the conduct anticompetitive because it was done at Netscape's expense and with the objective of preserving Microsoft's alleged monopoly position in operating systems.⁵² As such, the court focused on the impact of Microsoft's conduct on rivals and Microsoft's own market position but not specifically on the impact on marketwide output. The district court's analytical framework resembled generally the Second Circuit's condemnation of ALCOA's "doubling and redoubling" its capacity to thwart its rivals, to anticipate its customers' every need, and preserve its monopoly position.⁵³

Brooke Group on the other hand, required explicit recoupment in the context of pricing predation under the Robinson-Patman Act and section 2 of the Sherman Act, noting that, without recoupment, predation is "a boon to customers" though harmful to competitors.⁵⁴ *Rebel Oil Co. v. Atlantic Richfield Co.*,⁵⁵ following *Brooke Group*, described more fully the need for recoupment in an output-expanding predatory scheme,

⁵⁰ See *id.* at 326-31.

⁵¹ See *id.* at 54.

⁵² See *id.* at 326-31.

⁵³ See *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 431 (2d Cir. 1945).

⁵⁴ 509 U.S. 209, 224-25 (1993).

⁵⁵ 51 F.3d 1421 (9th Cir. 1995).

and identified recoupment as the source of the consumer injury necessary for liability in antitrust litigation:

Predatory pricing occurs in two stages. In the first stage, or "price war" period, the defendant sets prices below its marginal cost hoping to eliminate rivals and increase its share of the market. During this phase, the predator, and any rival compelled to challenge the predatory price, will suffer losses. *Though rivals may suffer financial losses or be eliminated as a result of the below-cost pricing, injury to rivals at this stage of the predatory scheme is of no concern to the antitrust laws. Only by adopting a long-run strategy is a predator able to injure consumer welfare.* A long-run strategy requires the predator to drive rivals from the market, or discipline them sufficiently so that they do not act as competitors normally should. If the predator reaches this long-run goal, it enters the second stage, the "recoupment" period. It then can collect the fruits of the predatory scheme by charging supracompetitive prices—prices above competitive levels.⁵⁶

To prove consumer injury, the *Rebel Oil* Court required either direct evidence of restricted output and supracompetitive prices or circumstantial evidence of market power and significant barriers to entry and mobility.⁵⁷

Where rivals are harmed through output-expanding conduct by a large market share holder, courts differ in the extent to which they require proof that the conduct will result in a subsequent restriction of some dimension of output (quantity, quality) or increase in price that affirmatively offsets the benefit to customers from the output expansion. Some courts, such as *Aluminum Co. of America*, and perhaps the district court in *Microsoft*, seem willing to presume that harm to rivals and the maintenance of a monopoly position, even through largely output-expanding conduct, will necessarily harm consumers by depriving them of the benefits that flow from rivalry among numerous competitors. Other courts, such as *Brooke Group* and *Rebel Oil* are unwilling to indulge in that presumption and do not condemn output-expanding conduct unless the plaintiff demonstrates that consumers will be injured through a subsequent, though foreseeable and offsetting, reduction in output and increase in price.

⁵⁶ *Id.* at 1433–34 (citations omitted and emphasis added).

⁵⁷ *See id.* at 1434.

C. Output-Restricting Conduct

Harm to rivals that results from output-restricting conduct often is challenged under section 1 of the Sherman Act, as it frequently involves an agreement among two or more actors that reduces or eliminates output to the harmed rival by the parties to the agreement.⁵⁸ Although the forms of output-restricting arrangements can vary widely, addressed here are only two forms to illustrate the differing willingness of courts to infer consumer injury from competitor harm.

In *SCFC ILC, Inc. v. Visa USA, Inc.*,⁵⁹ Sears, Roebuck and Company ("Sears"), owner of Discover Card, sued Visa U.S.A. Incorporated ("Visa") for refusing to admit Sears as a Visa member in violation of section 1 of the Sherman Act.⁶⁰ Sears argued that its marketing of the "Prime Option" card only as a Discover Card would not meet the objectives of Sears' "branding strategy," and that consumers would be harmed by being denied the opportunity to select a "Prime Option" Visa card among their possible choices in the general charge card market.⁶¹ The Tenth Circuit began its assessment of Sears' claim by identifying consumer welfare as the interest to be protected under the antitrust laws: "To be judged anticompetitive, the agreement must actually or potentially harm consumers. That concept cannot be overemphasized and is especially essential when a successful competitor alleges antitrust injury at the hands of a rival."⁶² The Tenth Circuit next noted that consumer welfare must be assessed on a marketwide basis and that market power by the parties to the agreement was required for the agreement to alter the competitive structure of the relevant market:

Broadly, market power is the ability to raise price by restricting

⁵⁸ Monopolists, of course, also can engage in output-restricting conduct that may affect rivals' opportunities. See, e.g., *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605-11 (1985). In cases of output-restricting conduct by single firms, courts may assess, from an allocative efficiency standpoint, the net effect of the practice on marketwide output over a sustained period of time. For example, the output-restricting conduct may consist in the exercise of a contractual or intellectual property right that itself encourages output expansion by the monopolist and/or the rival through investment and innovation.

⁵⁹ 36 F.3d 958 (10th Cir. 1994).

⁶⁰ See *id.*

⁶¹ See *id.* at 969.

⁶² *Id.* at 965 (citation omitted).

output Without market power, consumers shop around to find a rival offering a better deal.

. . . .

[I]t is not the rule-making *per se* [by which Sears is excluded] that should be the focus of the market power analysis, but the effect of those rules—whether they increase price, decrease output, or otherwise capitalize on barriers to entry that potential rivals cannot overcome.

. . . .

[D]oes [the rule] restrain trade in a manner which alters *the structure of the general purpose credit card market* and, thus, harms consumers?⁶³

Although the Court found that Sears had not proven that it could introduce a Prime Option card only with Visa's help,⁶⁴ the Tenth Circuit focused almost entirely on the effect of the exclusion not on Sears or Discover Card but on the structure of the relevant market. The court thus found:

[T]he evidence established the current market in general purpose credit cards is structurally competitive, issuers targeting different consumer groups and consumer needs. In this market, Sears already competes vigorously. Surely, if its goal is to compete *more effectively* in that market, we do not believe this objective constitutes the proverbial sparrow the Sherman Act protects. "[A] producer's loss is no concern of the antitrust laws, which protect consumers from suppliers rather than suppliers from each other."⁶⁵

In contrast, the Federal Trade Commission's (the "Commission") case against Toys "R" US (TRU)⁶⁶ focused more on the effect of TRU's restraint on the discounting warehouse clubs than on the marketwide impact of that restraint. TRU was found to have acted in concert with toy manufacturers to restrict the type of toys sold by toy manufacturers to warehouse clubs, which typically offered toys at low prices with little service.⁶⁷ Significantly, the Commission found that the relevant market within which the practices should be assessed was the "retail toy market," thereby including specialty superstores such as TRU,

⁶³ *Id.* at 965, 968, 970 (emphasis added).

⁶⁴ *See id.* at 972.

⁶⁵ *Id.* (citations omitted).

⁶⁶ *In re Toys "R" Us*, No. 9278, 1998 WL 727602, at *2 (F.T.C. Oct. 13, 1998).

⁶⁷ *See id.* at *15.

mass merchandisers such as Walmart and Kmart, and wholesale clubs such as BJ's and Costco.⁶⁸

In its rule of reason analysis of the competitive effects of TRU's conduct, the Commission acknowledged that the clubs at their peak accounted for only 1.9% of the relevant market and that, by 1995, that share had fallen to 1.4%.⁶⁹ The Commission further acknowledged TRU's argument that any conduct reducing output by only .05% of total market sales could not materially affect price or output on a marketwide basis.⁷⁰ The one-half percent reduction in the clubs' output could easily be offset by a slight increase in output by any one of the competitors accounting for more than the remaining 98% of total market sales.⁷¹

The Commission, however, drew a direct relationship between harm to a rival—even a small rival—and harm to competition and, in turn, harm to consumers:

Far from a single small business, the clubs were growing chains of retailers operating hundreds of outlets nationally and employing a distinctly new and efficient method of distribution. Because the boycott injured the clubs, it also harmed competition, and because competition was harmed, consumer welfare was reduced. Although the antitrust laws protect competition and not competitors, there can be no competition without able competitors. A policy that selectively eliminates effective competitors (or the ones most threatening to incumbent firms) harms the *competitive process* even though individual firms are the targets.⁷²

⁶⁸ See *id.* at *55.

⁶⁹ See *id.* at *29.

⁷⁰ See *id.* at *69.

⁷¹ See *id.*

⁷² *Id.* (emphasis added). In *Microsoft* the court of appeals also used the term "competitive process" with ambiguous import. 253 F.3d 34, 58 (D.C. Cir. 2001). In addition, Justice Breyer has also identified on several occasions protection of the "competitive process" as the basic objective of the antitrust laws. See, e.g., *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 21 (1st Cir. 1990) ("[A] practice is 'anticompetitive' only if it harms the competitive process."); see also *Clamp-All Corp. v. Cast Iron Soil Pipe Inst.*, 851 F.2d 478, 486 (1st Cir. 1988) ("Anticompetitive . . . refers . . . to actions that harm the competitive process."). Most recently, in *NYNEX Corp. v. Discon, Inc.*, Justice Breyer identified the "competitive process" as the object of antitrust protection no less than seven times. 525 U.S. 128, 135–40 (1998). He noted in *NYNEX* that harm to the "competitive process" entails more than harm to a "single competitor" and requires an injury to "competition itself." *Id.* at 135. But Justice Breyer did not clarify in *NYNEX* whether "competitive process" is synonymous with "consumer welfare" and allocative efficiency or whether

The Seventh Circuit affirmed the Commission's decision on competitive effects, largely on the strength of the Commission's findings below.⁷³

The Commission implicitly conceded that the foregoing did not amount to a finding that TRU's conduct reduced output or increased price throughout the relevant market for the retail sale of toys. Importantly, however, the Commission concluded that proof that such an impact had actually occurred was not necessary to a determination that consumers had been harmed.⁷⁴ In support of its position, the Commission noted that the Supreme Court stated in *FTC v. Indiana Federation of Dentists*⁷⁵ that the conduct there at issue "is likely enough to disrupt the proper functioning of the price-setting mechanism of the market that it may be condemned even absent proof that it resulted in higher prices or, as here, the purchase of higher priced services, than would occur in its absence."⁷⁶ The Commission found that TRU's conduct was directly analogous to that of the Indiana Federation of Dentists and thus could be presumed to disrupt the proper functioning of prices throughout the retail market for toys, without proof that such an effect had or would occur.⁷⁷

The *Visa USA* and *In re Toys "R" Us* cases thus reflect a significantly different perspective on whether injury to consumers can be inferred from harm to a rival seeking to provide a discounted product through a means that may threaten the parties to the restraint. Both courts agreed that, in the rule of reason context, harm to consumers must be shown. They disagreed, however, on the proof necessary to establish that such harm did or would occur.

"competitive process" refers to the process of rivalry to which the Commission adverted in the *In re Toys "R" Us* decision and to which the D.C. Circuit may have referred in *Microsoft Corp.*

⁷³ See *Toys R Us v. FTC*, 221 F.3d 928, 934-35 (7th Cir. 2000).

⁷⁴ See *In re Toys "R" Us*, No. 9278, 1998 WL 727602, at *71 (F.T.C. Oct. 13, 1998).

⁷⁵ 476 U.S. 447 (1986).

⁷⁶ See *In re Toys "R" Us*, at *71 (F.T.C. Oct. 13, 1998).

⁷⁷ *Id.* *California Dentist* acknowledged that *Ind. Fed'n of Dentists* properly invoked the quick-look doctrine. *California Dental*, 526 U.S. 756, 770 (1999). In that quick-look context, as clarified by *California Dentist*, actual proof of competitive effect was not required before the burden of demonstrating a procompetitive effect was shifted to the defendant. The continuing vitality of the use of *Ind. Fed'n of Dentists*, in the wake of *California Dentist* as support for the Commission's discussion of the need (or lack thereof) to prove marketwide impact in the context of a full rule of reason analysis may thus be subject to question.

D. Reducing "Consumer Choice" Through Harm to Rivals

Some have also argued that harm to rivals causes consumer harm by reducing the choices available to consumers—namely, the choices that rivals offered to consumers before the rivals were harmed.⁷⁸ For example, the Commission's decision in *In re Toys "R" Us* identified as a form of consumer injury a reduction in the range of choices available to consumers that resulted from the harm that TRU inflicted upon the warehouse clubs:

[TRU's conduct] reduced the range of choices available to consumers and eliminated forms of competition that consumers desired and would have been able to enjoy absent TRU's policy. Club shoppers were not able to buy the products they wanted at the clubs. They either had to buy their second-choice goods (e.g., custom or combo packs of goods) at their first-choice stores (warehouse clubs) or their first-choice goods (e.g., individually packaged branded toys) at their second-choice stores (TRU, Wal-Mart, Target).⁷⁹

The *Microsoft* case also included much discussion of "consumer choice" as a legally significant consumer injury.⁸⁰ The Department of Justice (DOJ) argued that Microsoft reduced consumer choice by reducing the significance of Navigator and Java on the competitive landscape.⁸¹ As a result of Microsoft's alleged predation, Navigator and Java were used less widely and, given the typical network effect of reduced distribution, became less attractive to consumers.⁸²

Other courts are less inclined to credit reduced consumer choice if the reduction is not marketwide or, put differently but to the same effect, if the consumer has reasonably

⁷⁸ See *supra* note 7.

⁷⁹ *In re Toys "R" Us*, No. 9278, 1998 WL 727602, at *71 (F.T.C. Oct. 13, 1998).

⁸⁰ See *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 37 (D.D.C. 2000) *aff'd in part, rev'd in part*, 253 F.3d 34 (D.C. Cir. 2001), (stating that reducing the ability of other firms in the relevant market to offer customers choices is central to identifying "exclusionary" conduct); see also *Microsoft*, 253 F.3d at 87 (stating that the primary rationale for the rule against tying is that "tying prevents goods from competing directly for consumer choice on their merits").

⁸¹ See *Microsoft*, 87 F. Supp. 2d at 39.

⁸² See *id.* Microsoft also allegedly reduced consumer choice by imposing on consumers a free copy of Internet Explorer with every new copy of Windows and by restricting OEMs from altering the start-up sequence or eliminating the Internet Explorer icon from the Windows desktop. Such conduct, however, involves restrictions relating only to Microsoft's own product offerings, not to marketwide alternatives.

interchangeable substitutes available. As the Federal Circuit recently held in *Intergraph Corp. v. Intel Corp.*, "harm to an individual competitor or consumer is not sufficient" to constitute a violation of section 2 of the Sherman Act.⁸³ Nor does harm to an individual consumer imply harm to all consumers in a relevant market, as consumers differ considerably in the intensity of their preferences for a particular price/quality mix in a given good or service.⁸⁴ The downward sloping demand curve in every market reflects differing intensities among consumer preferences for the relevant product.

Assuming that promoting allocative efficiency remains the objective, the question is presumably not whether one or another consumer's range of choice (or even consumption of the relevant good) has been limited. Rather, the question is whether the production or consumption of all goods in the relevant market has been materially reduced on an aggregate basis due to the challenged practice. Asking whether "consumer choice" has been limited may thus be just another way of asking whether marketwide consumption has been reduced, which in turn is just another way of asking whether the market-clearing output level has been decreased and the proper allocation of resources distorted. The inquiry may thus remain at the marketwide and aggregate level, not at the level of an individual or a cluster of individuals, regardless of whether the individuals are sellers or buyers.

Defining the relevant scope of output is a crucial issue in assessing whether a "marketwide" effect has or will likely occur. If the range of relevant output is limited to that of the rival (e.g., customers of warehouse clubs, accounting for 1.9% of the total consumption in the relevant market), then harm to rivals will necessarily imply consumer injury through reduced output and restricted consumer choice. If, however, reasonably practicable alternatives (toys purchased through all retailers, including TRU and mass merchandisers) are included in the range of relevant output, then harm to a rival may leave consumers (or other

⁸³ *Intergraph Corp. v. Intel Corp.*, 195 F.3d at 1356 (Fed. Cir. 1999) (quoting *Mr. Furniture Warehouse, Inc. v. Barclays Am./Commercial Inc.*, 919 F.2d 1517, 1522 (11th Cir. 1990)).

⁸⁴ See *UNR Indus., Inc. v. Cont'l Ins. Co.*, 623 F. Supp. 1319, 1328 (N.D. Ill. 1985) (noting that consumers through the relevant market, not just isolated consumers, are necessary for a Sherman Act violation).

rivals) with sufficient alternatives so that total output and consumption are unaffected by the conduct in question.⁸⁵

We turn next to a consideration of differing approaches that courts have taken in defining the relevant scope of output to be used to determine whether or not a “marketwide” impact has occurred.

III. “MARKETWIDE” IMPACT: NEXT BEST SUBSTITUTES OR FUNCTIONAL INTERCHANGEABILITY?

Merger decisions addressing competition among (1) retail formats, (2) products located along an extended price/quality spectrum, and (3) sellers located in adjacent geographic areas provide useful examples of courts’ assessing whether the relevant scope of output includes only next best substitutes (the output primarily of closely situated merging parties) or the full range of functionally interchangeable alternatives (the output of the merging parties and a variety of other competitors). In each case, the competitive effects assessment turned primarily on the court’s determination of the scope of relevant output.⁸⁶

A. Retail Format

Two cases illustrate the differing results that occurred when the pertinent output was limited to the merging parties’ retail format⁸⁷ and when it was defined more broadly in terms of functional interchangeability.⁸⁸ Although cases always turn on

⁸⁵ Some courts include reasonably practicable alternatives within the scope of relevant output despite claims that a subset of those alternatives is preferable to others. *See, e.g., PepsiCo., Inc. v. Coca-Cola Co.*, 114 F. Supp. 2d 243, 252 (S.D.N.Y. 2000) (asserting that a preference for one form of delivery by certain customers does not define a market when other forms of distribution are viable) “Whether or not a customer would have chosen bottler delivery of Pepsi given a *choice* between bottler and distributor delivery is irrelevant to the determination that an equivalent product can be obtained through other means.” *Id.*; *see also Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162–63 (9th Cir. 1997) (stating that the relevant scope of output in assessing vertical foreclosure is not limited to the most efficient, advantageous, or attractive means of distribution; rather, the relevant scope of output must include the full range of reasonably interchangeable selling alternatives available to rivals).

⁸⁶ The discussions below of retail format, a price/quality continuum, and geographic consumption patterns, address only demand-side issues and do not consider the role of supply responses in a competitive effects assessment.

⁸⁷ *See FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997).

⁸⁸ *See United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121 (E.D.N.Y. 1997).

the unique factual context in which they arise, they can also reflect a difference in analytical perspective. *FTC v. Staples Inc.* focused on the strategic maneuvering between competitors that were closely situated on the competitive landscape, and *Long Island Jewish Medical Center* embraces a larger swath of that landscape by focusing on functional interchangeability.

The *Staples*. story is well known. The FTC proposed as a relevant market "the sale of consumable office supplies through office supply superstores."⁸⁹ Here the FTC used "consumable" to mean products that consumers recurrently buy and discard, such as paper, pens, file folders, post-it notes, computer disks, and toner cartridges.⁹⁰ That market included only Staples, Office Depot, and Office Max. The defendants suggested that the proper market was the overall sale of office supplies, of which the combined Staples and Office Depot accounted for only five and one half percent.⁹¹ After reviewing extensive pricing evidence and numerous internal documents of Staples and Office Depot, the court concluded that the "the sale of consumable office supplies through office supply superstores is the appropriate relevant product market for purposes of considering the possible anti-competitive effects of the proposed merger between Staples and Office Depot."⁹²

The *Staples* court seemed most influenced by pricing data and party documents that indicated that Staples' prices differed geographically depending, at least in part, on whether one or both of the other office superstores were present in the specific location.⁹³ Few would dispute that the office superstores are next-best substitutes for each other in the sale of office consumables and that each would likely be most concerned with the other in determining the price and selection of products and the location of new outlets. On the other hand, the court focused

⁸⁹ *Staples*, 970 F. Supp. at 1074.

⁹⁰ *Id.*

⁹¹ *See id.* at 1075.

⁹² *Id.* at 1080; *see also* *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 45-49, 58-61 (D.D.C. 1998) (restricting the relevant market to the wholesale distribution of pharmaceutical drugs and effectively limiting the relevant competitors in that market to national wholesale distributors); *Bon-Ton Stores, Inc. v. May Dep't Stores*, 881 F. Supp. 860, 872-73 (W.D.N.Y. 1994) (defining relevant product market as including "traditional department stores" and excluding other retail formats that sold similar merchandise of apparel and furniture).

⁹³ *See Staples*, 970 F. Supp. at 1080.

less on the extent that mass merchandisers and warehouse clubs effectively competed with the office superstores.⁹⁴

To the extent the court addressed superstore competition with mass merchandisers and warehouse clubs, it found that the other superstores were a considerably more important factor in the setting of Staples' prices than were either mass merchandisers or warehouse clubs.⁹⁵ The court's decision, however, did not compare levels of prices for similar office consumables across superstores, mass merchandisers, and warehouse clubs; did not estimate the extent of overlap in consumables offered by the various retail formats (e.g., such core products as paper, pens, pencils, etc.); and did not consider the number of common customers served by the retailers. Nor did the court cite evidence reflecting the responsiveness of warehouse and mass merchandiser prices or product offerings to changes in prices or offerings in superstores.

The office superstores' preoccupation with one another, given their similarity in format and offerings, may be neither surprising nor dispositive in defining the scope of relevant output from an economic perspective.⁹⁶ That is, focus on each other as the next-best substitute may not necessarily imply that both parties are not reasonably constrained by mass merchandisers or warehouse clubs with a somewhat different retail format.

For example, other retail formats may consist of a narrower array of consumables (though still including high-velocity items of most consumer interest) at prices that are not as consistently discounted, but located near a variety of other household consumables that may be purchased at the same time. The mass merchandiser format may provide greater convenience than the superstore format and may be in equilibrium with the superstore format at the price discrepancy between the two at pre-

⁹⁴ Recall that Complaint Counsel for the FTC had forcefully argued, and the Commission had crucially found, that superstores (e.g., Toys R Us), mass merchandisers (e.g., Walmart), and warehouse clubs (e.g., Costco) directly competed with each other in the *Toys "R" Us* case. See *In re Toys "R" Us*, No. 9278, 1998 WL 727602 (F.T.C. Oct. 13, 1998).

⁹⁵ *Staples*, 970 F. Supp. at 1076-80.

⁹⁶ See, e.g., D. Yao, *Business Strategy from Alternative Perspectives, Antitrust* (1998) (explaining that business documents may reflect strategic objectives not relevant to a competitive assessment from the perspective of an industrial organization economist).

transaction levels. If that discrepancy lessens due to a post-transaction price increase by the superstores, common consumers may find it uneconomical to spend the time and energy to make a separate stop at the superstore for what is reasonably available at the mass merchandiser.

When confronted with remarkably similar issues in a different industry within four months of the *Staples* decision, the *Long Island Jewish Medical Center* court embraced a broader scope of output as relevant in assessing the competitive impact of the proposed merger between Long Island Jewish Medical Center (LIJ) and North Shore Manhasset (NSM).⁹⁷ In a story less well-known than *Staples*, the DOJ proposed a market in *Long Island Jewish Medical Center* consisting of primary and secondary health care provided by anchor hospitals in Queens and Nassau counties.⁹⁸ "Anchor hospitals" were defined as hospitals "having prestigious reputations, broad ranging and highly sophisticated services, and high quality medical staffs."⁹⁹ The DOJ:

distinguishes between the "general acute care hospitals" and the major prestigious acute care "anchor" hospitals like [North Shore Manhasset] and LIJ, which are in "a [unique] market to serve as an anchor hospital for a managed care plan." [DOJ] asserts that "community hospitals are not reasonably interchangeable" with anchor hospitals.¹⁰⁰

The DOJ further emphasized that the merging parties in *Long Island Jewish Medical Center* would have market power only in primary and secondary care, relative commodities in the health care industry.¹⁰¹ The DOJ did not contend that the merging parties would have market power in tertiary care, which involves more specialized, complex, and expensive procedures.¹⁰²

⁹⁷ See *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121, 137, 141 (rejecting the government's proposed relevant product market that included primary and secondary care, but excluded tertiary care).

⁹⁸ See *id.* at 140 (explaining the proposed geographic market as the area surrounding the merging hospitals in Nassau and Queens).

⁹⁹ *Id.* at 137.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* (limiting the government's version of the product market to only primary and secondary care, excluding tertiary care at anchor hospitals).

¹⁰² See *id.* at 138. Note the testimony of Dr. Vistnes, Assistant Chief Economist at the Antitrust Division of the DOJ: "Q: And do you believe that after the merger of [NSM] and [LIJ] will be monopolist for tertiary care services? A: No, I do not." *Id.*

The thrust of the DOJ's case in *Long Island Jewish Medical Center* was almost identical to that of the FTC's case in *Staples*. In both instances, the enforcement agencies argued that the merging parties were closely situated on the competitive landscape—essentially next-best substitutes. The agencies further argued that, through the proposed merger, the merging parties would acquire market power in the sale of a commodity product that, although otherwise available, could be obtained only through differently configured sources that were not in the relevant product market.¹⁰³ Yet those arguments prompted opinions that could not read more differently.

The *Long Island Jewish Medical Center* court rejected the DOJ's product market definition and found that primary and secondary health care services were available from a variety of community hospitals:

The Government has failed to establish that the acute inpatient services produced at these so called "anchor hospitals" are unique and would support its own relevant product market. As set forth above, approximately 85 percent of the services provided by LIJ and NSM involve primary and secondary care. The evidence is clear that these services are offered by numerous other hospitals in Nassau and Queens. The Court finds that with regard to primary and secondary care services, LIJ and NSM competes [sic] with the community hospitals in Nassau and Queens, such as Mercy, Mid-Island and South Nassau Community in Nassau and Elmhurst Hospital Center, Flushing Medical, Peninsula Hospital Center and St. John's Episcopal in Queens.¹⁰⁴

The court further found that the reputation of the merging parties as anchor hospitals would not prevent their patients from seeking the primary and secondary care elsewhere in the event of a post-transaction price increase:

Indeed, in the Court's view, the Government essentially concedes this point. Rather than argue that these services are unavailable elsewhere, the plaintiff maintains that the "reputation" of LIJ and NSM is what separates them from the crowd The problem with this "reputation" evidence is that it is based on "perception" of where patients currently go, *rather than where they could practically go for acute care inpatient*

¹⁰³ See *id.* at 143 (arguing that the merger will result in a 20% price increase for primary and secondary services).

¹⁰⁴ *Id.* at 138.

services in the future. The more material question is not the present customer's perception of the available hospital care, but the future likelihoods.

....

Also, the Court finds that the Government's characterization of an anchor hospital as a relevant product market is unnecessarily restrictive in that it fails to take into consideration the dynamics of the marketplace.

The *Long Island Jewish Medical Center* court rejected the retail format as the critical element in market definition, noting that the proper relevant market would be the provision of "general acute care inpatient hospital services, rather than the provision of these services by anchor hospitals."¹⁰⁵

Having identified the scope of pertinent output on which to assess competitive impact, the *Long Island Jewish Medical Center* court reached a conclusion diametrically opposed to that of the *Staples* court despite the fact that the merging parties were next-best substitutes:

In the defined relevant product and geographic markets, the Government failed to prove, by a preponderance of the evidence, that the merged entity would, in all probability, produce an anti-competitive effect, by a price rise above competitive levels or a reduction in services. *The Court reaches this conclusion despite the fact that presently LIJ and NSM are two of the premier teaching hospitals in Queens and Nassau, are direct competitors, and would be sought after by MCOs.*¹⁰⁶

Staples and *Long Island Jewish Medical Center* thus provide differing views on the proper scope of pertinent output with respect to which competitive effect (or consumer injury) should be assessed. *Staples* focused on the immediate competition among closely situated retailers and the impact of the proposed transaction solely on office superstore output. *Long Island Jewish Medical Center* rejected the retail format as relevant and embraced the characteristics of the service, its general

¹⁰⁵ *Id.* at 138–40; see also *PepsiCo, Inc., v. Coca-Cola Co.*, 114 F. Supp. 2d 243, 249–52 (S.D.N.Y. 2000) (rejecting a proposed relevant market limited to a form of distribution and finding that alternative forms of distribution, even if less desirable or efficient, presented practicable alternatives to cola syrup manufacturers); *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162–63 (9th Cir. 1997) (noting that the relevant scope of output includes both direct sales to end users as well as sales through distributors).

¹⁰⁶ 983 F. Supp. 121, 145 (E.D.N.Y. 1997) (emphasis added).

availability, and the reasonably practicable alternatives of consumers (i.e., where consumers could practically go) in the event of an increase in price or reduction in output of the merging parties.

B. Product Spectrum

Determining where to define relevant boundaries on a price/quality product spectrum was usefully addressed in *United States v. Gillette Co.*¹⁰⁷ In that case, Gillette Company ("Gillette") offered to purchase Parker Pen Holdings, Ltd.¹⁰⁸ The DOJ sued to enjoin the transaction on the ground that it would lessen competition in the "premium fountain pen market."¹⁰⁹ Defendants claimed that a market for fountain pens may not be segregated from a continuum of prices and quality on which fountain pens are offered¹¹⁰ and that the market definition should be expanded to include other writing instruments.¹¹¹

The court addressed the continuum issue primarily on the basis of functionality or the use to which the writing instruments are put. It found that fountain pens of less than \$50 are "base" fountain pens and used for ordinary writing purposes. Fountain pens between \$50 and \$400 are used for prestige and image purposes along with functional writing.¹¹² Fountain pens of \$400 and up primarily serve as collector items and jewelry pieces.¹¹³ The court used those different functions to define reasonable interchangeability and to accept that premium fountain pens are sold in a different market from those in which base and jewelry fountain pens are sold.¹¹⁴

The court then addressed the crucial question of whether premium fountain pens form a market distinct from other

¹⁰⁷ 828 F. Supp. 78 (D.D.C. 1993).

¹⁰⁸ See *id.* at 79–80 (stating that on March 23, 1993, Gillette offered to buy all outstanding stock and options of Parker).

¹⁰⁹ See *id.* at 80 (noting that based on 1991 sales, Gillette controlled approximately twenty-one percent of the U.S. premium fountain pen sales as compared to Parker, which controlled a nineteen percent share).

¹¹⁰ See *id.* at 81. (arguing that the government cannot exclude pens with suggested retail prices of less than fifty dollars or more than \$400 in its definition of relevant product market).

¹¹¹ See *id.*

¹¹² See *id.*

¹¹³ See *id.* at 82.

¹¹⁴ See *id.*

premium writing instruments.¹¹⁵ The court acknowledged that plaintiff had demonstrated that some set of fountain pen consumers are dedicated to premium fountain pens and that such consumers will not substitute another mode of writing (e.g., ballpoint pens, rollerball pens, or mechanical pencils) when confronted with a non-trivial, non-transitory price increase in fountain pens.¹¹⁶ But the court found that the set of fountain pen devotees does not encompass the entire universe of fountain pen consumers:

The record indicates that there is a much larger subset of fountain pen consumers who *will* substitute other modes of writing for fountain pens; for these customers, fountain pens therefore are in direct competition with these other modes This market is defined as all premium writing instruments (which the court will, for purposes of this discussion, define as mechanical pencils and refillable ballpoint, rollerball, and fountain pens with [suggested retail prices] from \$40-\$400).¹¹⁷

The *Gillette* court implicitly distinguished between inframarginal (or particularly loyal) and marginal (less loyal and willing to substitute an alternative product) consumers, a distinction that has become part of common antitrust parlance. Concluding that the merging parties' marginal consumers of premium fountain pens were sufficiently numerous to render a price increase unprofitable, the court found that the relevant scope of output on which impact was to be assessed included all forms of premium writing instruments.¹¹⁸

The *Long Island Jewish Medical Center* court, though not referring to a marginal-consumer analysis, seems to have

¹¹⁵ See *id.* at 83.

¹¹⁶ See *id.*

¹¹⁷ *Id.* at 83 (citation omitted). Implicit in the *Gillette* court's market definition is a determination that the pen manufacturers could not identify and discriminate between fountain pen devotees and less loyal fountain pen consumers. The court did not address whether, if a class of fountain pen devotees had been identifiable, it would have either acceded to a market definition based upon their subjective preferences or defined the market from an objective perspective according to reasonably practicable alternatives (i.e., other premium writing instruments serving the dual purposes of writing and prestige). The *Long Island Jewish Medical Center* court, 983 F. Supp. at 140, and the Eighth Circuit in *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1054 (8th Cir. 1999), both used a "practicable availability" standard for defining the scope of relevant output in assessing competitive effect. Although neither court addressed the issue of "objectivity" or "subjectivity," that standard appears to be objective and based upon functional interchangeability.

¹¹⁸ *Gillette*, 828 F. Supp. at 85.

employed at least a variation on that theme. Even if a set of patients found the reputation of LIJ and NSM to be a compelling reason to seek primary or secondary care at those institutions in the face of a price increase, the community hospitals provided, from an objective standpoint, a sufficiently acceptable alternative source of primary and secondary care to support a finding of reasonable interchangeability. *Staples* on the other hand, seemed to have assumed that few of the office superstore customers were marginal. In other words, the *Staples* court seemed to assume that most, if not all, office superstore customers did not shop for paper, pens, and pencils at other retailers or practicably could not do so even in the face of a material price or output effect at office superstores.

C. Geographic Consumption Patterns

The court in *FTC v. Tenet Health Care Corp.*¹¹⁹ reviewed a formal “critical loss” analysis based on the concepts of inframarginal and marginal consumers implicitly employed by the court in *Gillette*. The FTC argued that the relevant geographic market for the two merging hospitals in Poplar Bluff, Missouri consisted of the area in which the hospitals obtained ninety percent of their patients—namely, a fifty-mile radius from downtown Poplar Bluff.¹²⁰ Although that geographic area included four other hospitals, the proposed merger would result in the merging parties’ having an eighty-four percent share of patient hospital usage.¹²¹

The defendants proposed a relevant market that encompassed a sixty five-mile radius from downtown Poplar Bluff in addition to a hospital in St. Louis.¹²² Defendants’ proposed geographic market included sixteen hospitals in addition to those in the FTC’s proposed geographic market.¹²³ Defendants supported their proposed market by arguing that the merged entity would be unable to raise prices without causing the “critical loss” of sufficient marginal consumers to make the

¹¹⁹ 186 F.3d 1045 (8th Cir. 1999).

¹²⁰ See *id.* at 1052 (noting that a service area is not always the same as the merging firm’s geographic market area in antitrust analysis).

¹²¹ See *id.* (stating that the four other hospitals consisted of a Tenet-owned regional hospital and three rural hospitals).

¹²² See *id.*

¹²³ See *id.*

increase unprofitable.¹²⁴ The court described the critical loss analysis upon which it relied as follows: "A 'critical loss' analysis would identify the threshold number of patients who, by seeking care at other hospitals, could defeat a price increase by making it unprofitable. The purchasing behavior of these patients or 'marginal consumers' would discipline or constrain any potential price increase by a merged entity."¹²⁵

The defendants' economist testified that, based upon the critical loss analysis that he had performed, "if the merged hospital were to raise prices, enough patients would leave the merged hospital and seek care at an alternative hospital to render the price increase unprofitable."¹²⁶ In this regard, defendants showed that many commercially insured patients already sought treatment at hospitals outside Poplar Bluff for services that were available in Poplar Bluff hospitals.¹²⁷

The Eighth Circuit agreed with the defendants and held, "[T]he district court improperly discounted the fact that over twenty-two percent of people in the most important zip codes already use hospitals outside the FTC's proposed market for treatment that is offered at Poplar Bluff hospitals. The district court also failed to fully credit the significance of the consumers who live outside Poplar Bluff, particularly those patients within the FTC's proposed geographic market who actually live or work closer to a hospital outside that geographic market than to either of the Poplar Bluff hospitals The proximity of many patients to hospitals in other towns, coupled with the compelling and essentially unrefuted evidence that the switch to another provider by a small percentage of patients would constrain a price increase, shows that the FTC's proposed market is too narrow."¹²⁸

Like the *Long Island Jewish Medical Center* court, the Eighth Circuit also discounted the testimony of market participants regarding their choices in the event the merging parties raised prices on the ground that the "market participants spoke to current competitor perceptions and consumer habits and failed to show where consumers *could practicably go for*

¹²⁴ *Id.* at 1053.

¹²⁵ *Id.* at 1050.

¹²⁶ *Id.*

¹²⁷ See *id.* (using a zip-code-by-zip-code "contestability analysis" to show that patients would switch hospitals to defeat a price increase).

¹²⁸ *Id.* at 1053-54.

inpatient hospital services.”¹²⁹ Ultimately, the court described the competition between the merging parties in Poplar Bluff as a “war in a small corner of the market” and concluded that the antitrust laws do not require the preservation of that war when practical alternatives are available.¹³⁰

The *Tenet Health Care* court thus construed the next-best-substitute competition between the merging parties as occurring in a “small corner of the market.” According to the Eighth Circuit, when the scope of practicable alternatives to patients of the merging parties was properly defined, the merging parties had no power to affect “marketwide” output by imposing higher prices, providing less service, or otherwise harming patients’ interests. *Tenet Health Care*’s approach to assessing consumer injury was similar to that of *Long Island Jewish Medical Center* and *Gillette*, though different from that of *Staples*.

CONCLUSION

Courts and the enforcement agencies appear to agree that consumer injury is a necessary element in antitrust litigation not involving the per se rule of illegality or the quick-look doctrine and that such an injury generally involves a market-related impact on price or output. They differ, however, on the evidence required to prove that injury. Surveyed above are just two topics—harm to rivals and the proper scope of relevant output—on which courts and the enforcement agencies have differed in assessing the marketwide impact of a challenged practice. Those differences reflect the need to develop a consistent framework for assessing whether one or another form of challenged conduct has or will likely injure consumers.

¹²⁹ *Id.* at 1054 (emphasis added).

¹³⁰ *Id.* at 1055.

